

1
2 UNITED STATES BANKRUPTCY COURT
3 SOUTHERN DISTRICT OF NEW YORK

4 -----X
In Re: Chapter 11
5 LEHMAN BROTHERS Case No. 08-13555 (JMP)
HOLDINGS, INC., et al., (Jointly Administered)
6 -----)

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8 * * * HIGHLY CONFIDENTIAL * * *

9 DEPOSITION OF PHILIP E. KRUSE

10 New York, New York

11 Thursday, December 17, 2009
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20 Reported by:

FRANCIS X. FREDERICK, CSR, RPR, RMR

21 JOB NO. 26533
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5 December 17, 2009

6 9:32 a.m.
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9 HIGHLY CONFIDENTIAL videotaped
10 deposition of PHILIP E. KRUSE, held at
11 the offices of Boies Schiller & Flexner,
12 LLP, 575 Lexington Avenue, New York, New
13 York, pursuant to Notice, before Francis
14 X. Frederick, a Certified Shorthand
15 Reporter, Registered Merit Reporter and
16 Notary Public of the States of New York
17 and New Jersey.
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2 just -- I'm trying to be careful as to what
3 you're asking.

4 Q. Okay. The claim is that your
5 current knowledge of the value of the fed repo
6 collateral is privileged work product.

7 MR. TAMBE: No, that's not the
8 position and that's why we're running
9 into trouble here. You can have an
10 understanding as to --

11 MR. THOMAS: No, I asked him what
12 his current understanding was and he
13 said --

14 MR. TAMBE: And there was an
15 objection to that question.

16 MR. THOMAS: But he said it would
17 have to be biased upon privilege worked.

18 MR. TAMBE: And the reason there
19 was an objection to that question is you
20 seem to be trying to get at is there
21 independent valuation done by LBHI or
22 A&M independent of information. There's
23 lots of information on the record about
24 values ascribed to that collateral. On
25 and before the closing date. That's

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2 certainly within their understanding as
3 to values ascribed by others. Okay. Go
4 ahead.

5 MR. THOMAS: I'm not trying to --
6 I know there's nominal marks that exist
7 that he might have read in a paper or
8 something else like that. I'm asking if
9 Alvarez, prior to -- independent of what
10 is being claimed as work product made
11 any effort to value that collateral, the
12 fed repo collateral.

13 A. No, we did not.

14 Q. Okay. What was Alvarez's
15 understanding as to the value of the fed
16 collateral prior to doing this work product
17 with counsel?

18 A. Any understanding we had about
19 values ascribed to the collateral would have
20 been gained post closing and in connection
21 with the gathering of data so that we
22 understood the securities that were
23 transferred in connection with the
24 transaction.

25 Q. And as you sit here today can you

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2 tell me what that understanding was in terms
3 of the amount of the fed repo collateral?

4 A. I think it would be more
5 appropriate or perhaps more safe, rather than
6 having me misstate a number, I'm thinking of
7 e-mails that I know some of the A&M people
8 were gathering the data and I think those
9 documents represent what our early
10 understanding was of the ascribed values.

11 Q. Okay. After the sale closed, what
12 was the purpose of your trying to get an
13 understanding of the value of the assets that
14 had been transferred? Yours being Alvarez's.

15 A. It was really from the perspective
16 of capturing the data that we thought was
17 going to be necessary for us to administer the
18 estate and understanding what was estate
19 assets, what was not estate assets. I think
20 there was some thought early on that we would
21 try to do a reconciliation of the securities
22 that were transferred, ensure that nothing was
23 transferred that should not have been
24 transferred under the deal.

25 That effort was not really

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2 feasible based on the information available to
3 us in that first quarter of the administration
4 of the estate.

5 But the context was ensuring we
6 had the data in hand while it was fresh in
7 everybody's mind as to what was transferred in
8 the deal.

9 Q. Let me show you a document we'll
10 mark as 461A.

11 (Deposition Exhibit 461A, document
12 bearing production numbers AM 004503
13 through AM 004595, marked for
14 identification as of this date.)

15 BY MR. THOMAS:

16 Q. Is this a document that you've
17 seen before?

18 A. Yes. I've seen this.

19 Q. And when did you see it?

20 A. When did I see it?

21 Q. Yes.

22 A. I would have first seen it pretty
23 much contemporaneous with the date of this,
24 October 8th, or the day or two before.

25 Q. And can you describe what the

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2 document is, please.

3 A. It is a Powerpoint dec assembled
4 by Alvarez & Marsal to report to the Unsecured
5 Creditors Committee on this date of October
6 8th. It was sort of a guide for communication
7 to the Unsecured Creditors at that point.

8 Q. And why was Alvarez & Marsal
9 relaying this information to the Creditors
10 Committee?

11 A. It was in the context of the
12 Creditors Committee is an important
13 constituent that we serve in the
14 administration of the estate and giving them
15 an early download as to our activities and how
16 we're getting ramped up and getting ready to
17 best serve our role as a chief restructuring
18 officer.

19 Q. If I could ask you to turn to page
20 28, please.

21 A. (Witness complies.)

22 MR. ROTHMAN: The Bates number or
23 the page?

24 MR. THOMAS: That's the page
25 number. The Bates number is AM 4531.

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2 Q. And let me just ask, who would
3 have prepared this document?

4 A. Who physically prepared it?

5 Q. Yes. Or determined what went into
6 the document.

7 MR. TAMBE: Object to the form.

8 Go ahead.

9 A. The document as a whole would have
10 been a joint effort. I had some participation
11 in a slide or two here as well. So, you know,
12 depending on who you see as the leader or the
13 discussion leader on a given subject that's
14 likely the person who directed the
15 preparation. The physical preparation was
16 probably somebody working underneath that
17 particularly person.

18 Q. Did Alvarez work with anyone at
19 Lehman or Lazard or anyone other than Alvarez
20 to pull this information together?

21 A. Not to my knowledge.

22 Q. Do you know who would have
23 prepared the information that appears on page
24 28 of the document?

25 A. I would presume Jim Fogarty was

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2 MR. TAMBE: He's given you his
3 answer. And he's mentioned the GFS data
4 now. So what else do you want him to
5 talk about? He's told you the bases for
6 his understanding.

7 MR. THOMAS: I want to make sure
8 we close that out.

9 BY MR. THOMAS:

10 Q. So at this time, the time of this
11 document, at the time you were making your
12 presentation to the Creditors Committee, is it
13 fair to say that Alvarez believed the Lehman
14 marks were stale?

15 MR. TAMBE: Objection to the form
16 of the question.

17 A. No. I don't think that's a fair
18 characterization. I think this was the
19 recitation of something that was communicated
20 to us. I don't think we were making a
21 qualitative assessment that it was accurate or
22 inaccurate. We were simply communicating
23 information to a key constituent of ours.

24 Q. Do you know who communicated that
25 to Alvarez?

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2 A. I don't know specifically because
3 I didn't get a chance to get a hold of Jim
4 Fogarty in the last couple of days. He would
5 be the better person to ask. But I infer from
6 the documents I've seen Ian Lowitt or somebody
7 that worked with Ian Lowitt.

8 Q. Okay. You're aware that --

9 A. I'm sorry. Did I say Ian Lowitt?

10 Q. Yes.

11 A. I believe it was Paolo Tonucci.

12 Q. You're aware that Barclays did not
13 believe that the marks of the repo collateral
14 were still accurate as of the time of closing,
15 correct?

16 A. I'm sorry. Am I aware sitting
17 here today that Barclays doesn't believe those
18 marks were accurate?

19 Q. Right.

20 A. I understand that is an assertion,
21 yes.

22 Q. Okay. In any event, Alvarez
23 understood and communicated to the Committee
24 that there was a difference in the value of
25 the repo assets ascribed for purposes of the

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2 sales transaction and -- between that and
3 the -- what's referred to here as the stale
4 marks. The nominal marks on the fed repo
5 collateral.

6 MR. TAMBE: Objection to the form
7 of the question.

8 A. Sorry. I lost the train of that
9 question. Could you repeat it?

10 Q. Okay. Alvarez understood and
11 conveyed to the Committee at this time that
12 there was a difference between the Lehman
13 marks and the -- of the repo collateral and
14 the value of the repo collateral ascribed to
15 the repo collateral for purposes of the sale
16 transaction by the parties.

17 MR. TAMBE: Object to the form of
18 that question.

19 A. I think we've gone over this. You
20 know, I think the words communicate that
21 concept. I'm not necessarily agreeing that we
22 accepted it at the time as being -- you know,
23 I take this as Jim was relaying information
24 that we had come to understand through others
25 at that point. I don't think we were making a

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2 qualitative judgment at that point that it's
3 right, wrong, or otherwise.

4 Q. Well, putting aside whether it's
5 correct or not, that's what was being
6 conveyed, though; that there was this
7 difference between the old Lehman marks and
8 the parties' valuation of the repo collateral
9 for purposes of the sale transaction. That's
10 what the reduction is referring to, correct?

11 MR. TAMBE: Object to the form of
12 the question.

13 A. If I understand that correctly
14 that's probably a fair characterization.

15 Q. Okay. Let me ask it open ended.
16 What is the reduction that's -- the \$5 billion
17 reduction referring to there?

18 A. What is it referring to?

19 Q. Yes.

20 A. Well, it's referring to apparently
21 a negotiated difference between the value
22 which the assets were acquired versus the way
23 they were characterized prior to the
24 transaction.

25 Q. And Alvarez would have tried to

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2 make its presentation to the Creditors
3 Committee as accurate as it could, correct?

4 A. Yeah. We were certainly trying to
5 convey accurate information to the committee.

6 Q. And Alvarez also understood that
7 the -- if you look at the next bullet point --
8 that the sale transaction conveyed to Barclays
9 the unencumbered box?

10 A. Yes.

11 Q. And is the unencumbered box
12 referring to the clearance box assets?

13 MR. TAMBE: Object to the form.

14 Go ahead.

15 A. Is unencumbered box relating to
16 the -- unencumbered box I think refers to
17 unencumbered collateral that was transferred
18 that wasn't -- that didn't have a lien on it
19 prior to the transaction.

20 Q. Would you take a look back at the
21 clarification letter, please.

22 A. (Witness complies.)

23 Q. And if you would look at
24 Section -- paragraph 1(a)(ii)(B).

25 A. Yes.

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2 though, is was that Alvarez's understanding at
3 the time that Barclays was entitled to either
4 the 769 million of the 15(c)(3) securities if
5 permitted by law or if not permitted by law
6 securities of substantially the same nature
7 and value?

8 A. I'm not even sure I would go that
9 far. In the context of what we were trying to
10 accomplish at this time, you know, the
11 intricacies of customer property and things
12 that were probably under the purview at that
13 time of LBI wouldn't have been a particular
14 focus of ours. Obviously, it's here in the
15 document that was provided to us. The degree
16 to which Alvarez & Marsal focused on this or
17 really thought about it or considered it, I
18 wouldn't presume anything beyond that it's
19 here on the document.

20 Q. Is it your understanding at least
21 that that's what Weil was telling you was part
22 of the deal?

23 A. Well, I think the document speaks
24 for itself in terms of where it came from and
25 what it says.

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2 Q. So as part of its -- about how
3 many people at Alvarez were working on this
4 effort to try to assess the transfers, the
5 deal, during this period of time?

6 MR. TAMBE: Objection to the form
7 of the question.

8 A. Difficult for me to characterize
9 numbers of people. It was a substantial part
10 of our effort at that point. I think as it
11 relates to Barclays in particular, our focus
12 was on, you know, bearing in mind, of course,
13 that the business and all of its systems, its
14 records, all of its systems, and substantially
15 all of its employees were being moved over to
16 Barclays. The TSA, the Transition Services
17 Agreement, was the primary focus of ours as it
18 related to Barclays at the time. And so the
19 numbers of people -- there's within this
20 October 8th dec I think there's some depiction
21 of the numbers of people that we were gearing
22 up with at that time. But a substantial
23 portion of those people were involved in this
24 effort across multiple asset classes and
25 multiple teams that I think is probably best

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2 portrayed in this document at that time as
3 opposed to me trying to recite that for you.

4 Q. When Alvarez became aware of the
5 discount that we discussed and was in the
6 presentation to the Creditors Committee, did
7 Alvarez take any action or do anything with
8 respect to the fact that there was a discount
9 or a difference between the agreed value of
10 the repo collateral and certain marks?

11 MR. TAMBE: Objection to the form.

12 A. No, again, I would characterize,
13 you know, what we were doing at this time
14 relaying information that had been given to us
15 in connection with that transaction to our UCC
16 constituency. Some aspects of which they may
17 have known more than we did at the time
18 because they had perhaps people involved as
19 the deal was happening that weekend whereas we
20 did not. Did we take action? This was not a
21 priority at the time. We were not -- again,
22 as it relates to Barclays, the TSA was our
23 primary focus. Getting ourselves in a
24 position where we could run the wind-down of
25 this enormously large operation in a competent

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2 way, that was our focus.

3 Q. Did anyone at the Committee
4 express any surprise that there was a
5 difference between the agreed value of the
6 marks as part of the transaction and some
7 prior Lehman marks?

8 MR. TAMBE: Objection to form.

9 A. At this meeting? I think I
10 covered that.

11 Q. At the meeting -- okay. Let's try
12 it without the meeting.

13 A. I was not at the meeting so I
14 can't offer any insight.

15 Q. You tricked me.

16 Okay. At any time to your
17 knowledge.

18 A. Just to clarify, I was not at any
19 part of the meeting so I can't offer any
20 insight.

21 Q. At any time, to your knowledge.

22 A. At any time did -- I'm sorry. I
23 just want to make sure I got your question
24 straight. I've lost track.

25 Q. At any time did anyone, to your

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2 knowledge, from the Committee express, you
3 know, surprise about the fact that there was a
4 difference in the value of the fed repo
5 collateral agreed to by the parties for
6 purposes of the deal and the -- some nominal
7 prior Lehman marks?

8 MR. TAMBE: Objection to form.

9 A. You mean people sitting on the
10 Committee? I didn't have a lot of
11 communication with people sitting on the
12 Committee.

13 Q. That may be so but are you aware
14 of anyone on the Committee expressing surprise
15 about the fact that there was this delta?

16 A. Not that I'm aware. Again, there
17 may have been communications I'm not aware of.

18 Q. Are you aware of anyone else who
19 expressed surprise or indicated that that was
20 news to them? Anyone at Alvarez or LBHI or
21 anyone at this period of time?

22 MR. TAMBE: Objection to form.

23 A. My recollection during the first
24 quarter of our administration of the estate,
25 there was a gentleman from Houlihan, I believe

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2 Mike Fazio, who I think primarily indirectly
3 through others I understood that he was
4 expressing some concerns about the economics
5 of the deal and whether it was ultimately in
6 the best interest of the estate to have the
7 deal done as it was papered. I -- you know.

8 Q. Can you think of anything else
9 other than that?

10 A. Not that I recall.

11 Q. Was Mr. Fazio's expression of
12 concern more general or particularly with
13 respect to there being a delta between the
14 agreed value of the -- we'll call it the
15 discount as you've used the term.

16 A. My best recollection is that Mr.
17 Fazio was either -- attended or had heard
18 firsthand about a meeting that I know has been
19 depicted in the prior discovery Sun -- I
20 believe it was Sunday night before the deal
21 was closed Monday morning, where -- and I was
22 in the deposition of Michael Klein who
23 acknowledged that he had a depiction of the --
24 a very high-level depiction of the deal that
25 was written on the back of a manila envelope

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2 that was shown to Mike and/or others at
3 Houlihan.

4 I remember Mike telling us that
5 they, meaning as advisors to the Unsecured
6 Creditors Committee, had been asked -- had
7 asked Barclays and Lehman people for the
8 details behind the difference between the
9 marked values and what was determined to be
10 the negotiated value as depicted on that
11 envelope. And they were very unhappy with the
12 fact that they had never gotten any details.
13 They were promised the details at the time and
14 they never got them. And I think that was
15 part of what was underlying their concerns
16 about the economics of the deal.

17 Q. So they were aware of the delta
18 but they wanted to get details about the delta
19 further explained.

20 A. Sure. If you're a fiduciary for
21 the estate and you're aware of that you'd like
22 to have empirical knowledge, empirical
23 evidence of how it was derived rather than
24 just, you know, somebody saying it was
25 negotiated.

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2 Q. The sale transaction didn't
3 require the deal to be a wash, did it?

4 MR. TAMBE: Objection to form of
5 the question.

6 A. The sale transaction didn't
7 require the deal to be a wash?

8 Q. Okay. I'll rephrase that. Are
9 you familiar with the term "wash"?

10 A. Yes.

11 Q. What does that term mean to you?

12 A. Well, in the context I know where
13 you're coming from, it's assets essentially
14 equalled liabilities. And there was little to
15 no exchange of economic value in the deal.

16 Q. Okay. And little to no exchange
17 of economic value, can you explain to me?

18 A. Yeah. Wash assets equal
19 liabilities, that's how I'm trying to give my
20 understanding of what that concept means.

21 Q. It was never your understanding
22 there was something that sale transaction
23 documents required that assets match
24 liabilities; is that correct?

25 A. I don't think it was ever --

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2 MR. TAMBE: Objection to form of
3 the question.

4 A. I don't have any basis to think it
5 was characterized as -- in that way in the
6 sale documents. Although I would point out
7 that the Asset Purchase Agreement dated
8 October 16th, and I think this is depicted in
9 our Rule 60 papers, it really does -- the end
10 result of that appears to be assets equal
11 liabilities as it relates to the securities
12 and the comp and cure obligations being
13 assumed. And then you've got an additional
14 element of consideration if you want to look
15 at it that way by virtue of, you know, other
16 liabilities being assumed.

17 Q. Have you done an analysis of the
18 initial Asset Purchase Agreement to determine
19 what the actual liabilities would have been
20 and what the assets would have been?

21 A. Well, what I'm describing I think
22 is depicted in our Rule 60(b) motion. I can
23 picture it now. There's a little table in the
24 motion that depicts \$70 billion of long
25 positions, 69 billion of short positions,